

Internal Revenue Service  
Director, Exempt Organizations  
Rulings and Agreements

Department of the Treasury  
P.O. Box 2508 – Room 7008  
Cincinnati, OH 45201

Date: [REDACTED]

Employer Identification Number:  
[REDACTED]

Person to Contact – I.D. Number:  
[REDACTED]

Contact Telephone Numbers:

Phone

FAX

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a Trust, or Form 1120 if you are a corporation or an unincorporated association. Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

Enter Name of Organization  
[REDACTED]

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides, in part, that:

A declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination. In that event, appropriate State officials will be notified of this action in accordance with the provisions of section 6104(c) of the Code.

Sincerely,

[REDACTED]

Director, Exempt Organizations  
Rulings and Agreements

Enclosures:

Enclosure I

Publication 892

Form 6018

ORGANIZATION: [REDACTED]

CASE #: [REDACTED]

## ENCLOSURE 1

### ISSUE:

Is the organization qualified for exemption under Internal Revenue Code section 501(c)(3) as a charitable organization?

### FACTS:

The organization was formed as a corporation on [REDACTED] in the State of [REDACTED]. In the Second Section of the organization's Certificate of Incorporation, it states, "[The organization] has been organized and will be operated exclusively for the benefit of other charitable organizations organized under Section 501(c)(3) of the Internal Revenue Code..."

In Item 1 on Page 2 of Form 1023, it states:

The [REDACTED] will be operated exclusively for the benefit of other 501(c)(3) organizations for the purpose of handling all administrative and human resources responsibilities. A per employee fee will be charged to each organization on a monthly basis. By joining similar non-profit organizations together, this will enable the other 501(c)(3) organizations to offer better employee benefits, reduce overhead expenses, while at the same time freeing up time to allow the staff to focus on their core responsibilities (sic). The [REDACTED] will have several different divisions. There will be a church/mosque/synagogue division. There will be an educational division (focus on charter and private schools) and there will be an other (sic) division which will focus on non-profits which are funded by state and local governments.

[REDACTED] % of the work will be focused on handling payroll, employee benefits and the handling of all administrative responsibilities. The payroll and benefits is all web based and is handled by a third party contractor. These activities will allow the other non-profits to reduce their overhead expenses while at the same time freeing their staff to focus on their core purposes.

[REDACTED] % of the work will be in helping the non-profits right (sic) grants to Foundations, Governments, etc. to get additional funding for their organizations. Currently many non-profits cannot afford to hire a development

officer to help them receive funding. The [REDACTED] goal is to hire several grant writers whose goal will be to help all the other non-profits.

In the same section on Page 2 of Form 1023, it indicates that the organization initially plans to focus their work in the [REDACTED] / [REDACTED] metropolitan area for at least two years.

ORGANIZATION: [REDACTED]

CASE #: [REDACTED]

In Item 2 on Page 2 of Form 1023, it states that the organization's sources of revenues will be from the following:

- (1) A monthly fee will be charged to the various non-profits to cover the expenses.
- (2) Grants written to foundation. (Will not cover any of the organizations expenses but will go directly (sic) to the individual non-profits.

In Item 5 of the Service's correspondence dated [REDACTED] to the organization, it states:

In Item 10a on Page 4 of Form 1023 indicates that the organization's facilities or operations will be managed by another organization or individual under a contractual agreement. Please explain the relationship.

The organization's response dated [REDACTED] is as follows:

As indicated in our initial narrative description of our activities, we will be a web-based payroll and human resources company. We will contract with a payroll and human resources company to provide the back office work. They will charge us a one-time fee of \$[REDACTED] and then a per employee fee on a monthly basis in providing this technology. The monthly fee is broken down as follows: payroll service is \$[REDACTED] per employee; the web technology is \$[REDACTED] per employee; the intranet sites are \$[REDACTED] per employee (which provide email, online manuals, etc.) the HR Fix (which is an online employee manual, includes Title IX test for sexual harassment) is \$[REDACTED] per employee. Therefore our total costs are approximately \$[REDACTED] per employee.

The organization was asked to submit a copy of their fee schedule in Item 6 of the Service's correspondence dated [REDACTED] to the organization.

The organization's response dated [REDACTED] is as follows:

We anticipate charging \$[REDACTED] per employee (\$[REDACTED] of which will go toward the above). The remaining \$[REDACTED] will cover our expenses, which will be salaries, rent, training, etc. Our calculations indicate that we will save the non-profits more than \$[REDACTED] per month. For example, [REDACTED] employs [REDACTED] individuals and their average monthly health insurance cost is \$[REDACTED] per month and their average dental is \$[REDACTED] per month. For a total average cost of \$[REDACTED] per month. (sic) By joining with other churches to purchase both health and dental insurance it is estimated that

we will be able to save between [REDACTED]% and [REDACTED]% of those costs which would be between \$[REDACTED] and \$[REDACTED] per month. Also, there will not be any separate cost for payroll processing, which currently runs at \$[REDACTED] per employee per month.

In Item 7 of the Service's [REDACTED] correspondence to the organization, they were asked to explain how their organization differs from an organization that normally operates for

ORGANIZATION: [REDACTED]

CASE #: [REDACTED]

profit since fees will be charged.

The organization's [REDACTED] response is as follows:

Our organization differs from a for-profit organization in that any net earnings will be used to reinvest in the non-profits or to establish endowments for the non-profits benefit. Originally it was (sic) planned that the monthly charge would just be enough to cover the costs, but then I began to realize that by charging just a little higher price the net earnings could be used to further the non-profits purpose and provide more services for the non-profits. However, I realized that by charging them \$[REDACTED] more per employee would not make that much difference to the individual non-profits (because we are guaranteeing that the monthly charge per employee will save them money – see #6 above), but if I get [REDACTED] employees to join that would translate into \$[REDACTED] per month which the company could be either reinvested or used to establish endowments. Furthermore, as the number of employees grows the amount of money used to provide additional services or put aside for the endowments can grow. For example, if we end up getting [REDACTED] employees, that would translate into an additional \$[REDACTED] month. If you split equally between the additional services and the endowment – at the end of five (5) years you could have put aside \$[REDACTED] dollars for an endowment...

In Item 11 of the Service's [REDACTED] correspondence to the organization, it asked the following:

Please fully explain how the organization's per employee fees are determined (i.e. at, below or above market).

The organization's response in their [REDACTED] correspondence is as follows:

The per employee fee is substantially below market. A similar for profit PEO charges a minimum fee of \$[REDACTED] per employee and goes up to \$[REDACTED] per employee depending upon the amount of savings provided to the individual business. The \$[REDACTED] fee is based upon the ability of having a full-time administrator and assistant to run the business, which requires a minimum of \$[REDACTED] employees. If the number of employees is actually higher at the start it may allow the fee to be reduced to \$[REDACTED] per employee.

The organization requested their public charity classification as a supporting organization under Internal Revenue Code section 509(a)(3). Schedule D (Section 509(a)(3) Supporting

Organizations) was included with the application. On Schedule D, the organization listed four organizations that they support: [REDACTED]

[REDACTED] Item 1b on Page 19 of Form 1023 indicates that two out of the four organizations received rulings or determination letters that they are not private foundations.

ORGANIZATION: [REDACTED]

CASE #: [REDACTED]

In Item 14 of the Service's [REDACTED] correspondence to the organization, they were requested to submit copies of exemption letters from the Internal Revenue Service for [REDACTED] and [REDACTED]

Their response in the [REDACTED] correspondence is as follows:

I was not able to obtain a copy of [REDACTED] exemption letter in time to return this letter...Also, since we are not proceeding with the [REDACTED] [REDACTED] at this time, I have not included a copy of their exemption letter either.

In Item 12 of the organization's [REDACTED] correspondence, it states, "...it has been difficult to obtain a meeting with the [REDACTED], therefore we do not anticipate them to be one of the initial organizations."

In Item 15 of the organization's [REDACTED] correspondence, it states:

The [REDACTED] is the [REDACTED] / [REDACTED] The reason why we listed the District Office was because of a contact I had at the District Office. The District Office has no authority, regarding payroll and health insurance over the churches. Therefore, we will be contracting with the individual [REDACTED] churches, of which there are currently [REDACTED] in the [REDACTED] / [REDACTED] area. For that reason, I have not submitted a copy of the church's exemption letter.

Incidentally, despite the organization's plans to receive foundation grants and distribute the funds directly the nonprofits, revenues from grants as well as expenses relating to the distribution of grants were not reflected in the organization's proposed budgets on Page 8 of Form 1023 and its attachment.

#### LAW:

Organizations exempt under Section 501(c)(3) of the Code are defined as:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying

on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

ORGANIZATION: [REDACTED]

CASE #: [REDACTED]

Regulations section 1.501(c)(3)-1(c)(1) states "An organization will be regarded as 'operated exclusively' for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Paragraph (2) of the same Regulations section states "An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals"

Regulations section 1.501(a)-1(c) defines a private shareholder or individual as "persons having a personal and private interest in the activities of the organization."

The term "charitable" is defined in Regulations section 1.501(c)(3)-1(d)(2) as follows:

**The term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions. Such terms include: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency. The fact that an organization which is organized and operated for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily prevent such organization from being exempt as an organization organized and operated exclusively for charitable purposes.**

Some of the charitable purposes listed in the regulation defining charity are particularly relevant to modern urban problems. These purposes included the promotion of social welfare by lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency.

Revenue Ruling 72-369, 1972-2 CB 245 found "an organization formed to provide managerial and consulting services at cost to unrelated exempt organization does not qualify

for exemption under section 501(c)(3) of the Code." In this ruling, an organization was formed to provide managerial and consulting services for exempt organizations, which would improve the administration of their charitable programs. Providing the services at cost and solely for exempt organization was not sufficient to characterize the activity as

ORGANIZATION: [REDACTED]

CASE #: [REDACTED]

charitable.

Revenue Ruling 71-529, 1971-2 CB 234 determined "a nonprofit organization that provides assistance in the management of participating colleges' and universities' endowment or investment funds for a charge substantially below costs" qualified for exemption under Internal Revenue Code section 501(c)(3).

### ORGANIZATION'S POSITION:

In response to the Service's correspondences dated [REDACTED] and [REDACTED] the organization submitted correspondence dated [REDACTED]. It states:

I have not had the opportunity to do extensive research regarding your denial of our request for tax exempt (sic) status. However, in reviewing the term "charitable" one of the definitions included "lessening the burdens of government for the following reasons:

- 1) By reducing the overhead costs of the 501(c)(3) organizations that are funded by the State of [REDACTED] this will help reduce the burden for funding on the State of [REDACTED]. Also, any grants received by these organizations will also further reduce this burden. In fact, it is the State of [REDACTED] policy to reduce the amount of funding to the organization, when it receives outside funds.
- 2) The Churches, Synagogues and Mosques all have ministries that help the poor and if these organizations were not in existence the money necessary to provide services to the poor would fall upon the County, State and Federal Governments. By helping the Churches, Synagogues and Mosques reduce their health insurance and overhead costs, frees up more money to provide services to the poor. Therefore, our organization would be "lessening the burdens of government."
- 3) The Child Care Centers that qualify as 501(c)(3) organizations usually provides services to the poor and parents trying to get off welfare. By helping the child care centers reduce their health insurance and overhead costs, it will allow more money to provide the needed services. Again, it is our position that our organization would be "lessening the burdens of government", by offering this service.

The organization submitted another letter dated [REDACTED] to present more information on why the organization should be granted exemption. It states:

I was discussing further with one of the people involved with the [REDACTED] and he gave me some additional reasons why [the organization] meets the definition of "charitable" by "lessening the burdens of government".



ORGANIZATION: [REDACTED]

CASE #: [REDACTED]

I was discussing further with one of the people involved with the [REDACTED] and he gave me some additional reasons why [the organization] meets the definition of "charitable" by "lessening the burdens of government".

As indicated in our original application there are over [REDACTED] different non-profits in the [REDACTED] area. Each one of those organizations has to:

- 1) File both Federal and State Payroll Returns;
- 2) File Federal Tax Returns for their 401(k) or 403(b) Plans; and
- 3) Be rated individually by the states for workman's compensation.

Assuming that we obtain [REDACTED]% of the non-profit employers ([REDACTED]), then we would only have to file one (1):

- 1) Federal and State Payroll Return;
- 2) Federal Tax Returns for our 401(k) or 403(b) Plan; and
- 3) Be rated once for workman's compensation (by each state).

As a result, we have *substantially* "lessened the burdens of government", by reducing the number of various Federal and State Returns needed to be filled and reviewed from [REDACTED] to [REDACTED] each. The Federal Government alone will have almost [REDACTED] fewer returns to file and review...

### SERVICE'S POSITION:

According to Revenue Ruling 85-1, an activity is a burden of government if there is an objective manifestation by a governmental unit that it considers the activities of the organization to be its burden. Whether an objective manifestation exists may be shown by a variety of factors. Such factors include the following:

- 1) Whether an organization is formed pursuant to a state statute. The statute clearly defines the organization's structure and purposes.
- 2) Interrelationship with a governmental unit – the stronger the control a government has over the organization's activities, the more an objective manifestation exists.
- 3) A governmental unit previously conducted the organization's activity.
- 4) Payment of governmental expenses if the organization defrays the general or specific expenses of a local government or pays part of the government's debt is evidence of a governmental burden.
- 5) Sources of funding – if an organization regularly receives funding from the government in the form of general grants, as opposed to fees for services, there is indication that the government considers the activity to be its burden.
- 6) Whether an activity is one that could be performed directly by a governmental unit.

ORGANIZATION: [REDACTED]

CASE #: [REDACTED]

In Revenue Ruling 78-68, it found that an organization formed as a Model Cities demonstration project under the Demonstration Cities and Metropolitan Development Act... to provide bus transportation to isolated areas of a community not served by the existing city bus system qualified for exemption under 501(c)(3) because it provided bus service under the authority of the Federal and local governments.

In Revenue Ruling 71-29, an organization qualified as a charitable organization because it provided a grant to a city transit authority for the purpose of maintaining a mass transportation system.

In Revenue Ruling 70-583, a nonprofit organization formed to develop and manage community correctional centers for the rehabilitation of prisoners in cooperation with the courts and governmental custodial agencies qualified for exemption under 501(c)(3).

### **CONCLUSION:**

Based on the information presented by the organization, The [REDACTED] does not qualify for exemption under Internal Revenue Code section 501(c)(3) as a charitable organization.

Like the organization described in Revenue Ruling 72-369, providing service at cost and solely for exempt organizations is not sufficient to characterize the activity as charitable. Therefore the organization's activity of handling all administrative and human resources responsibilities of organizations exempt under Section 501 (c)(3) for a fee, even at cost, is not a charitable activity. Additionally, no evidence was presented to show that the organization's activities lessen the burdens of government.